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**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA**

State of Arizona, et al.,

No. CV-24-00355-PHX-GMS

Plaintiff,

ORDER

V.

United States Internal Revenue Service, et al.,

Defendants.

Pending before the Court is Plaintiff's Motion for Preliminary Injunction (Doc. 18).

For the reasons detailed below, the Court declines to issue such an injunction.

BACKGROUND

Arizona seeks to enjoin the United States Internal Revenue Service (“IRS”) from imposing and collecting federal income tax on an Arizona Tax Rebate that was granted last year.

On March 13, 2020, the President declared a national emergency pursuant to the National Emergencies Act based on the outbreak of COVID-19. (Doc. 24 at 7). In 2022, 21 states made special payments to their citizens in part to provide relief during the pandemic. (Doc. 18-1 at 6). In early 2023, recipients of these payments were confused as to whether the payments were includable in taxable income for their 2022 federal tax returns. (*Id.* at 6–9). Acknowledging this confusion, the IRS issued guidance (“IR-2023-23”) on how it would treat those 2022 payments for the purpose of federal

1 income tax. (*Id.*)

2 The IRS has determined that in the interest of sound tax
 3 administration and other factors, taxpayers in many states will
 4 not need to report these payments on their 2022 tax
 5 returns . . . [T]he IRS has determined . . . given the fact that the
 6 pandemic emergency declaration is ending in May, 2023
 7 making this an issue only for the 2022 tax year, if a taxpayer
 8 does not include the amount of one of these payments in its
 9 2022 income for federal income tax purposes, the IRS will not
 10 challenge the treatment of the 2022 payment as excludable for
 11 income on an original or amended return.

12 (Id. at 6–7). On August 30, 2023, the IRS issued more guidance to further clarify what
 13 types of special payments from states are includable in federal taxable income. (Doc. 18-1
 14 at 63–64). That guidance (“IR-2023-158”) went beyond the earlier IR-2023-23 guidance,
 15 which was solely focused on special payments made in 2022, to explain what types of
 16 payments are typically exempt from federal income tax:
 17

18 **Most taxpayers receiving state tax refunds do not have to
 19 include the state tax refund in income for federal tax
 20 purposes.** As a general rule, taxpayers who choose the
 21 standard deduction on their federal income tax returns do not
 22 owe federal income tax on state tax refunds.
 23

24 (Id.). But, as the guidance went on to specify for those who itemize:

25 Payments made by states under legislatively provided social
 26 benefit programs for the promotion of the general welfare are
 27 not included as income on an individual recipient's federal
 28 income tax return. To qualify for the general welfare
 29 exclusion, state payments must be paid from a governmental
 30 fund, be for the promotion of general welfare (that is, based on
 31 the need of the individual or family receiving such payments),
 32 and not represent compensation for services. Determining
 33 whether payments qualify for this exclusion is a complex, fact-
 34 intensive inquiry that depends on a number of considerations.

35 (Id.) (emphasis in original).

1 In February 2023, the Secretary of Health & Human Services provided a 90-day
2 notice to Governors that the COVID-19 national emergency would expire on May 11,
3 2023. (*Id.* at 59). On May 11, 2023, the day that COVID-19 lost national emergency
4 designation, Governor Hobbs signed Senate Bill 1734 (“Arizona Tax Rebate”) into law.
5 (Doc. 18 at 10). That bill authorized onetime payments to Arizona taxpayers who claimed
6 a dependent tax credit and had a tax liability of at least \$1 in the 2021, 2020, or 2019 taxable
7 year. (*Id.* at 52–53). The onetime payments were \$250 per dependent under the age of 17
8 (\$100 for dependents over 17) claimed in the 2021 tax year. (*Id.* at 53). Qualifying
9 taxpayers were entitled to credits for up to three dependents. (*Id.*). The bill did not
10 authorize any payments for families that did not owe tax in the relevant years, nor did it
11 cap total payments to actual Arizona income tax liability for the relevant years. (*Id.* at
12 52–57). The payments could be issued no earlier than October 15, 2023. (*Id.* at 54). The
13 payments were explicitly excluded from recipients’ Arizona gross income: “In computing
14 Arizona adjusted gross income, any rebate received by a taxpayer pursuant to this section
15 and required to be included in Arizona gross income under the internal revenue code shall
16 be subtracted from the taxpayer’s Arizona gross income.” (*Id.*). The bill also included
17 legislative findings:

18 L. The legislature finds that:
19 1. Inflation is at a forty-year high, putting gas, groceries and
20 other necessities out of reach for many Arizonans.
21 2. Responsible budgeting has allowed this state to take action
22 to mitigate the harmful impacts of inflation by returning a
portion of the surplus to this state’s taxpayers with dependents.

23 (*Id.* at 55).

24 In August 2023, the IRS issued Notice 2023-56 to describe the rules it applies when
25 determining the tax treatment of state refunds or payments. (Doc. 18 at 11; Doc. 18-1 at
26 66–81). On August 30, 2023, the IRS hosted a call for states to “share and discuss the
27 substance of [IR] 2023-56.” (Doc. 24 at 8; Doc. 24-1 at 2). A representative from the
28 Arizona Department of Revenue (“ADOR”) was on that call. (Doc. 24 at 8). On October

1 3, 2023, the ADOR asked the IRS for guidance on whether the payments would be
2 includable in federal taxable income. (Doc. 24-1 at 5-7). In his email to the IRS, the tax
3 policy executive for ADOR stated that “[w]hether Arizona’s rebate is subject to federal
4 income tax is ultimately a federal determination.” (*Id.* at 6). He also explained that:

Arizona's rebate was enacted after the federal government lifted the Covid emergency and based on what I read it seemed at that point that Arizona's 2023 rebate would likely be taxable. I later read the [IR-2023-158] and thought it was possible that Arizona's rebate could fall under the general welfare provisions.

10 *(Id.* at 5). In a follow up email sent on November 16, 2023, the Arizona tax policy
11 executive wrote “[w]e don’t need official legal guidance or anything like that, just sort of
12 a head’s up (taxable or not taxable) . . . [t]he issue is we are currently having to proceed as
13 if the rebate is taxable for federal purposes.” (Doc. 24-1 at 4). The ADOR further indicated
14 it was already preparing 1099s for payment recipients. *(Id.*). In a meeting on December
15 7, 2023, the IRS informed the ADOR that the payments were not exempt from treatment
16 as income. (Doc. 24 at 8). The ADOR made 1099s available to all recipients by January
17 31, 2024. *(Id.* at 9).

18 On February 21, 2024, Arizona filed this suit against the IRS alleging violation of
19 equal sovereignty, unlawful taxation of non-income, unlawful denial of general welfare or
20 disaster relief exclusions, violation of the APA, and violation of Congress’s taxing power.
21 (Doc. 1 at 15–19). On February 28, 2024, Arizona moved for a Preliminary Injunction,
22 asking this Court to enjoin the IRS from imposing and collecting federal income tax from
23 the Arizona Tax Rebate. (Doc. 18-3 at 1).

24 The State acknowledges that it does not and cannot assert the interest of its taxpayers
25 in seeking to avoid the tax. “The State . . . is not seeking—and cannot seek—direct
26 monetary relief on behalf of its taxpayers.” (Doc. 18 at 25). Yet, it alleges that, as a
27 political entity, it has suffered damage separate from that suffered by its taxpayers from the
28 IRS’s determination to tax the rebate. First, the State alleges the asserted loss of \$480,000

1 in transaction privilege taxes that the State will not receive because the amount of the
 2 federal tax liability on their state rebates will not be available for taxpayers to spend in
 3 Arizona. (*Id.* at 25). Second, it alleges damage due to its obligation to issue 1099s to
 4 rebate recipients. (*Id.* at 24–25). Third, it alleges sovereign injuries because the IRS treated
 5 Arizona’s 2023 tax rebate differently than it treated the 2022 rebate of 21 other states. (*Id.*).

DISCUSSION

I. Jurisdiction

Implicit, of course, in this Court’s authority to grant an injunction is the requirement
 that the Court have jurisdiction to hear the State’s claims. Yet Ninth Circuit precedent
 casts considerable doubt on this prerequisite.

a. Anti-Injunction Act

The Anti-Injunction Act (“AIA”) states “no suit for the purpose of restraining the
 assessment or collection of any tax shall be maintained in any court by any person, whether
 or not such person is the person against whom such tax was assessed.” 26 U.S.C. § 7421(a).
 “The manifest purpose of [the AIA] is to permit the United States to assess and collect
 taxes alleged to be due without judicial intervention, and to require that the legal right to
 the disputed sums be determined in a suit for refund.” *Enochs v. Williams Packing & Nav.*
Co., 370 U.S. 1, 7 (1962).

In *Confederated Tribes and Bands of Yakama Indian Nation v. Alcohol & Tobacco*
Tax & Trade Bureau, 843 F.3d 810 (9th Cir. 2016), the Tribe, a tribal corporation, and a
 tribal member sought to enjoin the imposition of excise taxes on tobacco products
 manufactured by the tribal corporation. *Id.* at 811. Based on the Anti-Injunction act, the
 district court dismissed the tribal citizen and the tribal corporation but found that it had
 jurisdiction over the Tribe’s claim despite the Act. *Id.* at 812, 815. On appeal, despite the
 district court’s denial of the Tribe’s claims on the merits, the *Yakama Nation* Court found
 that the AIA completely deprived the district court of jurisdiction over the Tribe’s claims.
 It disclaimed the district court’s reliance on *South Carolina v. Regan*, 465 U.S. 367 (1984),
 noting that in *Regan* the state did have an interest that was not derivative of the interests of

1 its taxpayers in that “the state’s interest in issuing bonds in the form it chose existed
 2 separately from the bondholders’ interest in avoiding taxation.” *Id.* at 815 (citing *Regan*,
 3 465 U.S. at 380–81). But it noted that the *Regan* exception to the AIA “is a narrow one”
 4 to be narrowly applied. 843 F.3d at 815 (citing *Am. Bicycle Ass’n v. United States*, 895
 5 F.2d 1277, 1281 (9th Cir. 1990)). Under the facts of *Yakama Nation*, the court noted, the
 6 Tribe’s injury “flows from the taxation of its members, and thus is wholly derivative” of
 7 the injuries to the Tribal citizen and corporation. *Id.*¹ Because the injury was derivative,
 8 the Tribe could reasonably expect its interests to be adequately represented and protected
 9 in a suit or a refund claim brought by an individual citizen or the tribal corporation. *Id.*
 10 *Yakama Nation* is difficult to fairly distinguish from the facts here.

11 Of course, as the State points out, the Second Circuit in *New York v. Yellen*, 15
 12 F.4th 569 (2nd Cir. 2021), does attempt to distinguish *Yakama Nation*. It does so by
 13 asserting the injuries are not wholly derivative because of “the absence of taxpayers in this
 14 litigation, in contrast to the important role of the manufacturer and the individual tribal
 15 member in the proceedings in *Yakama Nation* to undo the tax that was most directly
 16 imposed on them.” *Id.* at 579. Nevertheless, *Yellen* does nothing to explain how the
 17 presence or absence of other Plaintiffs in a suit bears any relation to whether the state’s
 18 claims are derivative of those of its taxpayers. Further, the posture of *Yakama Nation*,
 19 undermines *Yellen*’s attempt to distinguish it. While the tribal member and manufacturer
 20 in *Yakama Nation* had been parties to the suit, they were no longer so by the time the matter
 21 reached the *Yakama Nation* Court. In other words, the AIA barred the Tribe’s suit not
 22 because other Plaintiffs were involved, but because other Plaintiffs could bring a suit to
 23 obtain the same relief for themselves and, by extension, the Tribe.

24 That is the posture before this Court. Plaintiff’s alleged loss of transaction privilege
 25 taxes flows directly from the tax treatment of its taxpayers and is wholly derivative of its
 26

27 ¹ In this respect the *Yakama* Court also noted that there was no distinction between a Tribe
 28 as Plaintiff and a State as Plaintiff. “All of these various textual and contextual clues in
 the Internal Revenue Code and the Anti-Injunction Act specifically overcome any
 presumption that ‘person’ does not include the sovereign” *Id.* at 814.

1 taxpayers' injuries. *Yellen* improperly analyzes what claims are "wholly derivative" of
 2 injuries to taxpayers and, in so doing, inaccurately distinguishes Ninth Circuit precedent.
 3 This Court is bound by *Yakama Nation*, not *Yellen*.²

4 The Court, therefore, believes it unlikely that it has jurisdiction to hear this particular
 5 claim wholly apart from whether the state has met its burden to receive a preliminary
 6 injunction based on it.

7 **1. It Is not Apparent that the State's Issuance of 1099's Constitutes Injury
 8 or, if so, Would Be Ameliorated by Injunctive Relief.**

9 To the extent that the state asserts it is damaged by having to issue 1099's on its
 10 state tax rebates, the state has not met its burden of establishing either that this constitutes
 11 damage or, if it does, that it is the appropriate subject of injunctive relief. It appears the
 12 United States tax code required Arizona to issue 1099s regardless of the IRS's tax treatment
 13 of the payments. *See* 26 U.S.C. § 6050E(a). Emails between the ADOR and IRS indicate
 14 as much. (Doc. 24-1 at 4; Doc. 24-2 at 3). It does not then appear that the issuance of
 15 1099's constitutes injury to Arizona. In any event, Arizona has apparently already prepared
 16 and made available 1099s to relevant taxpayers. (Doc. 18 at 13). As such, there is no
 17 action regarding the 1099s to enjoin. *BrakeMark USA LLC v. Pastis*, No. CV-23-02674-
 18 PHX-SMB, 2024 WL 810635, at *4 (D. Ariz. Feb. 27, 2024) ("The purpose of a
 19 preliminary injunction is not to remedy past harm but to protect plaintiffs from irreparable
 20 injury that will surely result without their issuance.") (quoting *DTC Energy Grp., Inc. v.*
 21 *Hirschfeld*, 912 F.3d 1263, 1270 (10th Cir. 2018)).

22 **2. This Court Likely Has No Jurisdiction Over Arizona's Sovereignty
 23 Claim to the Extent That Claim Also "Flows from the Taxation of its
 24 Taxpayers."**

25 As a basis for obtaining preliminary injunctive relief, the State did not flesh out with

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 27 ² In an attempt to assert standing Arizona points to the commerce clause challenge raised
 28 by Wyoming against Oklahoma state law in *Wyoming v. Oklahoma*, 502 U.S. 437, 448
 (1992). In contrast, the IRS compares Arizona's position to *Pennsylvania v. New Jersey*,
 426 U.S. 660, 665 (1976) another case in which states sued states. In such cases, of course,
 the Anti-Injunction Act would have had no application.

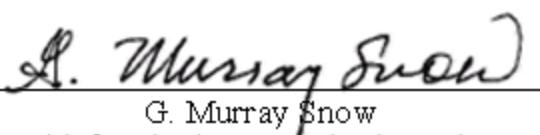
1 great clarity how the taxation of the state rebate infringes Arizona's sovereignty. In its
2 briefing the State describes such damage as "the IRS's disparate treatment of Arizona
3 without reasoned basis" or that the state's "inability to enforce its duly enacted plans"
4 because "each individual Arizona taxpayer files a federal tax return sending money to the
5 IRS that the State had intended to remain in Arizona." (Doc. 18 at 25).

6 Of course, as explained above, any asserted damage of Arizona's sovereignty that
7 "flows from the taxation of its [taxpayers]" is not a claim over which this Court likely has
8 jurisdiction. Arizona may be asserting some sort of sovereignty claim that is not so derived.
9 But, if so, the contours of such a claim, as it now stands, are insufficiently defined for this
10 Court to determine either that the State is likely to prevail, or to fashion preliminary
11 injunctive relief that is tailored to the damage asserted. In light of the United States' own
12 considerable and independent right to tax Arizonans who are also United States citizens,
13 *U.S. v. Burke*, 504 U.S. 229, 233 (1992) (quoting *Commissioner v. Glenshaw Glass Co.*,
14 348 U.S. 426, 431 (1955)); 26 U.S.C. § 61 ("Except as otherwise provided in this subtitle,
15 gross income means all income from whatever source derived"). the Court declines,
16 at least at this stage of the litigation, to enter an order declaring that the state tax rebate is
17 not subject to any federal taxation.

18 Accordingly,

19 **IT IS THEREFORE ORDERED** Plaintiff's Motion for Preliminary Injunction
20 (Doc. 18) is **DENIED**.

21 Dated this 5th day of April, 2024.

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23 _____
24 G. Murray Snow
Chief United States District Judge

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